

Message Text

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LIMDIS

PASS TREASURY FOR UNDER SECRETARY YEO AND SYVRUD

E.O. 11652: GDS

TAGS: EFIN, ECON, PO

SUBJECT: FINANCIAL ASSISTANCE FOR PORTUGAL

REF: LISBON 573

1. PATRICK DU FONTENAY OF IMF CALLED ON ECONOMIC COUNSELOR EVENING OF JANUARY 20 TO REVIEW HIS DISCUSSIONS WITH GOP. DU FONTENAY STATED THAT HE EXPECTED TO REACH ONLY AGREEMENT IN PRINCIPLE WITH GOP ON POLICY REQUIREMENTS FOR FIRST TRANCHE STANDBY, NOT ON DETAILED IMPLEMENTATION. HE ANTICIPATED, THEREFORE, THAT HE WOULD DEPART LISBON WITHOUT A LETTER OF INTENTION FROM GOP. IN SUCH A CASE, HE WILL GIVE GOP DRAFT PROPOSAL WHICH COULD SUBSEQUENTLY BE USED FOR DISCUSSIONS OF A FINAL AGREEMENT. DU FONTENAY AGREED THAT FIRST TRANCHE CONDITIONS WERE RELATIVELY SEVERE, BUT HE IS WILLING TO NEGOTIATE. HE CONCEDED, MOREOVER, THAT CONCLUSION OF FIRST TRANCHE AGREEMENT SHOULD, GIVEN SEVERITY OF REQUIREMENTS BEING DISCUSSED, FACILITATE LATER ACCORD ON A SECOND TRANCHE STANDBY. HE PREFERRED, HOWEVER, NOT TO TAKE THE INITIATIVE IN OPENING THAT POSSIBILITY.

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2. MAJOR DIFFICULTIES IN ACHIEVING FIRST TRANCHE STANDBY REVOLVE AROUND TWO POLICY ISSUES: 1) DEVALUATION AND 2) CREDIT TO THE EXPANDED PUBLIC SECTOR. DU FONTENAY ADMITTED THAT, ALTHOUGH HE IS FIRM ON THE NEED FOR A PROMPT AND SUBSTANTIAL DEVALUATION, HE WOULD RESPOND WITH SOME FLEXIBILITY TO A SERIOUS GOP PRESENTATION ON THE MOVE'S TIMING AND SIZE. FINANCE MINISTER

MEDINA CARREIRA, HE REPORTED, HAS ACCEPTED THE NEED FOR DEVALUATION, BUT CONTINUES TO STRESS THAT PRESENT TIMING IS NOT APPROPRIATE FOR A MAJOR CHANGE. DU FONTENAY BELIEVES CURRENT GOP POLICY, I.E. CRAWLING PEG, IS DISASTROUS IN THAT IT GIVES PORTUGAL THE WORST OF BOTH WORLDS. THE SECOND MAJOR STUMBLING BLOCK TO AN AGREEMENT, I.E., PUBLIC SECTOR CREDIT, STEMS FROM FEARS THAT GOP MAY NOT REACH ITS 1977 BUDGET DEFICIT PROJECTION. DU FONTENAY IS HIGHLY PESSIMISTIC ON THIS POSSIBILITY. HIS PESSIMISM APPEARS TO BE BASED LARGELY ON A BELIEF THAT THE SOCIAL SECURITY SYSTEM AND THE SUPPLY FUND WILL NOT BE ABLE TO MEET THE BUDGETARY TARGETS. HE HAS ALREADY RECEIVED AN INDICATION FROM BANK OF PORTUGAL GOVERNOR SILVA LOPES THAT THE IMF'S PROJECTED CREDIT LIMIT WOULD BE EXCESSIVELY RESTRICTIVE. DU FONTENAY HAS NOT, HOWEVER, RECEIVED A PORTUGUESE COUNTERPROPOSAL. NEGOTIATIONS TODAY WILL CONCENTRATE UPON THESE TWO MAJOR AREAS OF DIFFERENCE.

3. COMMENT: DESPITE DU FONTENAY'S REPORTED HARD POSITION, HE INDICATED A FAIR AMOUNT OF FLEXIBILITY. WE ARE NOT QUITE AS PESSIMISTIC AS HE ABOUT GOP BUDGETARY DEFICIT PROSPECTIVES FOR 1977. ALTHOUGH GOP MAY NOT BE ABLE TO CONSTRAIN ITS EXPENDITURES WITHIN THE LIMITS SET BY THE BUDGET, WE FEEL MUCH OF THAT INCREASED OUTLAY WILL BE OFFSET BY HIGHER THAN PROJECTED REVENUES. THE NORMAL CONSERVATISM OF PORTUGAL'S REVENUE FORECASTS IS, MOREOVER, HEIGHTENED THIS YEAR BY THE EFFECTS OF DEVALUATION, THE HIGHER THAN PROJECTED RATE OF INFLATION FOR 1977,
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AND GOP PLANS FOR ADDITIONAL TAX INCREASES. UNDOUBTEDLY SOME SUBSTANTIVE ISSUES, MOSTLY DEVALUATION, REMAIN UNRESOLVED. A MAJOR PROBLEM, HOWEVER, STILL SEEMS TO BE THE GOP AND FUND TENDENCIES TO TALK PAST, RATHER THAN TO, EACH OTHER. HOPEFULLY CURRENT CONVERSATIONS WILL HELP OVERCOME THIS IMPASSE.
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